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In the Supreme Court of the United States

OCTOBER TERM, 1969.

No. 294

SOUTHEASTERN CANTEEN CO.,
CANTEEN SERVICE CO. OF TOLEDO,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI
To the United States Court of Appeals
For the Sixth Circuit.

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COMMISSIONER OF INTERNAL REVENUE,
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PETITION FOR A WRIT OF CERTIORARI
To the United States Court of Appeals
For the Sixth Circuit.

Petitioners, Southeastern Canteen Co. and Canteen Service Co. of Toledo, petition that a writ of certiorari issue to review a judgment of the United States Court of Appeals for the Sixth Circuit denying in part Petitioner Southeastern Canteen Co.'s petition for review and affirming in part a decision of the Tax Court of the United States and to review a judgment of the United States Court of Appeals for the Sixth Circuit denying Petitioner Canteen Service Co. of Toledo's petition for review and affirming a decision of the Tax Court of the United States.

OPINIONS BELOW.

The opinion of the Court of Appeals (Appendix A), has not yet been reported officially.* The Decisions and Memorandum Findings of Fact and Opinion of the Tax Court of the United States (Appendix B) are reported at 36 P-H Tax Ct. Mem. 973 (1967).

* For convenience the appendix has been printed and bound separately.

JURISDICTION.

The opinion of the Court of Appeals for the Sixth Circuit was entered on May 13, 1969. On May 23, 1969, Petitioners filed a Motion to Stay the Mandate of the Court of Appeals and an Order of the Court of Appeals for the Sixth Circuit was entered on June 2, 1969 staying the issuance of the mandate for thirty days from June 2, 1969, pending the filing of a petition for writ of certiorari. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED.

1. Can the Court of Appeals, first conclude with the trial court that a single ultimate fact is determinative of the issues, then find the essential supporting evidentiary facts directly contrary to corresponding facts found by the trial court, and, at the same time, decide that the ultimate finding of the trial court is *not* clearly erroneous?

2. Whether the Federal Income Tax may be collected twice on the same income?

3. Whether decisions reallocating income between members of a family or between stockholders and their controlled corporation may be applied to disallow deductions for payments required to be made by a taxpayer to an unrelated and adverse party?

4. What is arm's length bargaining?

STATUTE INVOLVED.

The relevant provisions of the Internal Revenue Code of 1954, as amended, are set forth in Appendix C.

STATEMENT OF THE CASE.

In this case, the Court of Appeals for the Sixth Circuit affirmed in part the Decisions and Memorandum Findings of Fact and Opinion of the Tax Court of the United States. The Tax Court had disallowed the surtax exemption of Petitioner, Southeastern Canteen Co. for its taxable years ended October 3, 1959, October 1, 1960 and September 30, 1961. The Court of Appeals reversed and vacated the judgment of the Tax Court disallowing Petitioner, Southeastern Canteen Company's surtax exemption.

Petitioners are here requesting a review of the affirmance by the Court of Appeals of the Tax Court's judgment disallowing the deduction pursuant to Section 162(a)(3) of the Internal Revenue Code of 1954, of certain rentals and certain location commissions paid by the Petitioners.

A. THE FACTS.

1. The Organization and Operation of Canteen Service Co. of Toledo and Southeastern Canteen Co.

Canteen Service Co. of Toledo (hereinafter referred to as "Canteen Service"), was incorporated under the Laws of Ohio on March 16, 1946 with offices in Toledo, Ohio. (27a).[1] On March 16, 1946 Canteen Service issued 1,000 of its common shares to Ben T. Handwork in exchange for, among other things, a franchise granted by Automatic Canteen Company of America (hereinafter referred to as "Automatic") for the sale of candy, gum, nuts and other articles through automatic vending machines (32a). On July 6, 1947 Ben T. Handwork entered into a

[1] References, unless otherwise indicated, are to the Appendix of the Petitioners in the Court of Appeals.

new Franchise and Distributor's Lease Agreement with Automatic which provided for the sale of food and beverages through vending machines (hereinafter sometimes called "canteens") in certain counties of Northwestern Ohio. On July 6, 1947 Ben T. Handwork, with the consent of Automatic, assigned that Franchise and Distributor's Lease Agreement to Canteen Service and Canteen Service operated under that Agreement during its fiscal year ended September 30, 1961 (97a).

During the fiscal year ended September 30, 1961 all of the 750 outstanding common shares of Canteen Service were held and owned by Virgil A. Gladieux of Toledo, Ohio (28a, 55a). During the fiscal year ended September 30, 1961, Canteen Service maintained its books and records under the accrual system of accounting and it employed the thirteen (13) period system of tabulating its income and expenses, each such period consisting of four (4) weeks (28a). Canteen Service duly filed its Federal Income Tax Return for the fiscal year ended September 30, 1961 with the District Director of Internal Revenue in Cleveland, Ohio (Exhibit A).

Southeastern Canteen Co. (hereinafter referred to as "Southeastern") was incorporated on January 19, 1956, under the laws of the State of Michigan, with a registered office in Detroit, Michigan with operating offices in Monroe, Michigan and in Adrian, Michigan, and with offices of its officers in Toledo, Ohio (28a, 76a). Subsequent to the incorporation of Southeastern, its outstanding capital stock consisted of twenty common shares of which Virgil A. Gladieux owned fifteen and Ben T. Handwork owned five. On July 21, 1959, Southeastern redeemed the five common shares then owned by Ben T. Handwork and thereafter the entire outstanding common shares of South-

eastern, consisting of fifteen common shares, were held and owned by Virgil A. Gladieux (29a, 55a).

During the fiscal year ended September 30, 1961, Southeastern sold food and beverages through vending machines in two counties in Southeastern Michigan, those counties being those originally designated under the provisions of a certain Franchise and Distributor's Lease Agreement entered into by and between Automatic and Ben T. Handwork on January 20, 1956, and assigned to Southeastern on January 20, 1956, by Ben T. Handwork with the consent of Automatic (28a, 29a).

2. Background of the Canteen Service Co. of Toledo and Southeastern Canteen Co. Relationships with the Gladieux Corporation.

Gladieux Corporation was incorporated under the laws of the State of Ohio on July 16, 1931, under the name of Buddies Box Lunch, Inc. On September 18, 1944 its corporate name was changed to Buddies Lunch System, Inc. On August 3, 1955 its corporate name was changed to Buddies Food Services, Inc. and on November 2, 1960 its corporate name was changed to Gladieux Corporation (29a, 30a).

Prior to May 10, 1946, Gladieux Corporation (then known as Buddies Lunch System, Inc.) was principally engaged in the business of operating cafeterias and lunch counters and dispensing food in several manufacturing plants in the City of Toledo and vicinity, and it also sold candy, gum and nuts both over its counters and through vending machines at its food service locations, as well as at gas stations and other locations (37a).

On May 10, 1946, the outstanding capital stock of Gladieux Corporation was owned fifty per cent (50%)

by Virgil A. Gladieux and fifty per cent (50%) by Nelson Gladieux, brother of Virgil A. Gladieux. On May 25, 1955, Virgil A. Gladieux became the sole stockholder of the Gladieux Corporation (37a). On May 10, 1946 Ben T. Handwork was the sole stockholder of Canteen Service Co. of Toledo (37a).

On May 10, 1946 Gladieux Corporation (then known as Buddies Lunch System, Inc.) entered into an Agreement with Canteen Service whereby Gladieux Corporation transferred to Canteen Service its vending machine business (37a, 38a, 179a-191a). Under the terms of this Agreement of May 10, 1946, among other things, it was agreed that Canteen Service would pay to Gladieux Corporation location commissions of twelve per cent (12%) on all gross sales of candy, gum and nuts sold through vending machines at all locations where the Gladieux Corporation then, or thereafter, operated cafeterias, lunch counters or other food dispensing facilities for the full term of the Agreement and any extension or renewal thereof. The term of the Agreement was for five (5) years and thereafter until any party gave three (3) months' termination notice in writing to the other (179a-191a).

The sale of the Gladieux vending business to Canteen Service appealed strongly to Virgil A. Gladieux for financial reasons, since, under the Automatic franchise arrangement under which Canteen Service was then operating, it, Canteen Service, could lease its vending equipment from Automatic, whereas up to that time the Gladieux interests were compelled to purchase their vending equipment thus limiting their financial resources for any expansion program (56a).

After May 10, 1946, as other type vending machines became available, Canteen Service commenced to vend other products through the machines, such as milk, coffee,

ice cream and hot food, thus necessitating, for business reasons, adjustments to the rates of location commissions payable to the Gladieux interests by Canteen Service under the Agreement of May 10, 1946. The expansion of the vended food line resulted in an inconsistent pattern of location commissions payable to the Gladieux interests by Canteen Service under the Agreement of May 10, 1946. Up and until the latter part of the year 1960 the location commissions paid varied with respect to products and with respect to locations (56a, 57a, 58a).

From and after May 10, 1946 Canteen Service, pursuant to paragraph 4 of its Agreement with the Gladieux Corporation (then known as Buddies Lunch System, Inc.) dated May 10, 1946 (179a-191a), paid a location commission to the Gladieux interests of twelve per cent (12%) on sales made by Canteen Service through vending machines located at the facilities of the Libbey-Owens-Ford Glass Company (hereinafter referred to as "L.O.F."), since the Gladieux interests prior to and after May 10, 1946 were conducting an in-plant feeding activity at the facilities of L.O.F. and prior to May 10, 1946 the Gladieux interests had vending machines operating on the premises of L.O.F. In 1958, for good business reasons, the Gladieux interests temporarily waived the location commissions payable to them on the L.O.F. business. The location commissions of L.O.F. business were reinstated by the Gladieux Corporation as of September 30, 1960 (69a, 70a, 71a, 72a, 73a, 179a-191a, 207a-209a).

On or about December 4, 1953, Gladieux Corporation (then known as Buddies Lunch System, Inc.) commenced the operation of a restaurant and a cafeteria at the plant and facilities of the Toledo Scale Company and continued operations throughout the taxable year of Canteen Service which is involved in these proceedings. At or about the

same date, Canteen Service was permitted to install canteens at nine (9) different locations throughout the plants of the Toledo Scale Company. For good business reasons, the Gladieux interests temporarily waived a part of these location commissions and, as of September 30, 1960, these location commissions were reinstated (38a, 72a, 73a).

3. Petitioners' Relationships With ABC Vending Corporation.

a. Background.

On June 30, 1960 Virgil A. Gladieux and his wife, Beatrice G. Gladieux, held and owned all the outstanding capital stock of fifteen (15) corporations engaged in the merchandising and vending of food, beverages, cigarettes and gum in various areas of the United States. Included among these fifteen (15) corporations on June 30, 1960 were Canteen Service, Southeastern and the Gladieux Corporation (then named Buddies Food Services, Inc.) (30a).

Gladieux Corporation during the taxable year here involved operated various food systems, such as in-plant employee feeding for industrial concerns, operation of cafeterias, snack bars and dining rooms, and route sales of food and beverages from mobile vehicles (30a, 57a, 70a). The books and records of the Gladieux Corporation were maintained on the accrual system of accounting and on a calendar year basis (30a). During the years and periods here involved, and until February 2, 1961, all the outstanding capital stock of the Gladieux Corporation consisting of five hundred (500) common shares, without par value, was held and owned of record, but subject to the Agreement of June 30, 1960, as follows:

Virgil A. Gladieux	499 shares
Beatrice G. Gladieux (wife of Virgil A. Gladieux)	1 share

(30a, 150a-161a).

ABC Vending Corporation, a Delaware corporation (hereinafter referred to as "ABC"), immediately prior to June 30, 1960, was primarily engaged in the food and beverage vending and merchandising business with book net worth in excess of sixteen million dollars ($16,000,000) and with an annual vending volume in excess of sixty million dollars ($60,000,000). It was a publicly-owned corporation, its stock being listed on the New York Stock Exchange. In January of 1961, it had eight thousand five hundred and twenty-two (8,522) shareholders who owned one million two hundred twenty-eight thousand three hundred and twenty-eight (1,228,328) shares of common stock, including forty-eight thousand nine hundred and sixty (48,960) treasury shares. Prior to February 2, 1961, neither Virgil A. Gladieux nor Beatrice G. Gladieux owned any capital stock of ABC (30a, 31a).

b. The Agreement of June 30, 1960.

On June 30, 1960, ABC and Virgil A. Gladieux entered into an Agreement whereby Virgil A. Gladieux, among other things, agreed to transfer to ABC all of the outstanding capital stock of the fifteen corporations owned by him and his wife [including the outstanding capital stock of Canteen Service, Southeastern and Buddies Food Services, Inc. (name changed to Gladieux Corporation on November 2, 1960)] in exchange for eighty thousand (80,000) shares of the common capital stock of ABC. Pursuant to Article Fourth of this Agreement, it was contemplated that the closing date for the exchange of stock

would occur approximately ninety days after June 30, 1960, or on or about September 30, 1960 (31a, 67a, 68a).

c. Amendments to the Agreement of June 30, 1960.

Automatic refused to consent to the sale and transfer to ABC by Virgil A. Gladieux of the outstanding capital stock of Canteen Service and of Southeastern, relying on the provisions of Section 25 of its Franchise and Distributor's Lease and Agreement with Canteen Service (97a, 111a, 112a) and its similar Agreement with Southeastern (123a, 138a, 139a). Automatic's refusal was submitted to arbitration. On December 27, 1960 the arbitrators decided that Automatic's withholding of consent was not unreasonable, arbitrary or capricious (31a, 162a, 163a).

Prior to the decision of the arbitrators, ABC's representatives and Virgil A. Gladieux conducted negotiations to determine what course of action would be undertaken with respect to the exchange of stock contemplated by the Agreement of June 30, 1960 in the event that the arbitrators decided that the shares owned by Virgil A. Gladieux in the Petitioners could not be transferred to ABC (63a, 64a). Virgil A. Gladieux was not motivated in his thinking with respect to the possible rearrangement of the Agreement of June 30, 1960 by any avoidance or evasion of Federal Income Tax liability (69a, 70a), but rather was negotiating on behalf of the Petitioners with a desire to get the best possible arrangement for them from ABC. In the course of those negotiations, Virgil A. Gladieux was concerned particularly with respect to the following possibilities:

(1) If Canteen Service and Southeastern were to be omitted from the deal with ABC and if Virgil A. Gladieux was to be left with the ownership of those two corporations, he wanted to maintain a close relationship between

those corporations and the other Gladieux corporations, which would be then owned by ABC, since those other Gladieux corporations, through their food service arrangements in industry, controlled more than seventy-five per cent (75%) of the vending business operated by Canteen Service and Southeastern, and he wanted to be certain that Canteen Service and Southeastern would be assured of the continuity of the volume of their business (64a).

(2) He wanted to work out any rearrangement with ABC in such a way that Canteen Service and Southeastern would be assured of financial aid from ABC to assist them in the expansion of their facilities and in the acquisition of other vending businesses in their territories (64a).

(3) He desired that Canteen Service and Southeastern be assured against any operating losses (64a).

(4) He desired that the rates of location commissions being paid by Canteen Service and by Southeastern to the other Gladieux corporations, which were not uniform, be standardized so as to eliminate future controversies with respect to them and any claim of conflict of interest on his part, since ABC contemplated that Virgil A. Gladieux would continue as an officer of Gladieux Corporation and become an officer of ABC (65a, 66a).

(5) While he had the notion that during these negotiations the representatives of ABC had in mind a rearrangement which would enable ABC to take most of the profits of Canteen Service and Southeastern, he was of the opinion that the transaction could be rearranged so as to generate profits in those two companies (66a) by having ABC supply all of the operating equipment, thus eliminating rentals to Automatic, and by having ABC provide funds for the acquisition by Canteen Service and Southeastern of other vending companies in the territories with

the result that no rentals on such purchased equipment would be payable to Automatic (66a).

(6) During the period of those negotiations, he, Virgil A. Gladieux, was contemplating the acquisition by Canteen Service of certain other vending companies (66a, 67a).

During the negotiations, which took place before and after the decision of the arbitrators, by and between Virgil A. Gladieux for Canteen Service and Southeastern and representatives of ABC, it was agreed that the closing date for the transactions having to do with Canteen Service and Southeastern should be as of September 30, 1960, since that was the approximate closing date contemplated by the original Agreement of June 30, 1960 (150a-162a, 67a).

Renegotiation of the original Agreement culminated in the following Agreements being entered into on the dates indicated:

(1) A Supplemental Agreement between Virgil A. Gladieux and ABC dated January 26, 1961 which, among other things, eliminated the requirement that the shares of Canteen Service and Southeastern be transferred to ABC and reduced the number of shares of ABC stock to be transferred to Virgil A. Gladieux from 80,000 to 68,500 (31a, 32a, 164a, 165a);

(2) An Agreement between Virgil A. Gladieux, ABC, Canteen Service, Southeastern and Gladieux Corporation (formerly Buddies Food Services, Inc.) dated January 26, 1961 which, among other things, required Canteen Service and Gladieux Corporation, before closing, to enter into an Agreement for the sale of certain of the operating assets of Canteen Service to Gladieux Corporation, for the leasing of those assets by Gladieux Corporation to Canteen Service, the form and terms of this sale agreement and

of this lease being attached to the Agreement as an exhibit; required Southeastern and Gladieux Corporation, before closing, to enter into an Agreement for the sale of certain of the operating assets of Southeastern to Gladieux Corporation, for the leasing of those assets by Gladieux Corporation to Southeastern, the form and terms of this sale agreement and of this lease being attached to the Agreement as an exhibit, and *ABC agreed to cause Gladieux Corporation* to pay Canteen Service and Southeastern the considerations referred to in the Agreement (32a, 165a-168a);

(3). An Agreement between Canteen Service and Gladieux Corporation (formerly Buddies Food Services, Inc.) dated January 31, 1961 which, among other things, provided for the sale and transfer by Canteen Service to Gladieux Corporation of certain land, buildings, improvements, trucks, machinery, equipment, furniture and fixtures and vending machines for $184,659.83, that being the net book value thereof as of October 1, 1960; further provided for the lease by Gladieux Corporation to Canteen Service of the assets so purchased for a term of twenty (20) years from October 1, 1960, with certain renewal options, Gladieux Corporation further obligating itself to provide and lease to Canteen Service all additional equipment required by Canteen Service in the operation of its vending business. The rental under the lease was ten per cent (10%) of the gross sales of Canteen Service on and after October 1, 1960, with the limitation that if this rent resulted in an operating loss to Canteen Service, the amount of the rent for the fiscal period of the loss would be reduced by the amount of the loss. Net operating income was to be determined before federal income taxes and before certain other deductions. This Agreement also provided for the payment by Canteen Service to Gladieux

Corporation, from and after October 1, 1960, of location commissions on all sales at vending locations at any time derived through Gladieux Corporation, or any corporation affiliated with Gladieux Corporation, or through Virgil A. Gladieux, at uniform rates as set forth in a schedule attached to the Agreement (32a, 169a-174a);

(4) An Agreement between Southeastern and Gladieux Corporation (formerly Buddies Food Services, Inc.) dated January 31, 1961 which, among other things, provided for the sale and transfer by Southeastern to Gladieux Corporation of certain trucks, furniture and fixtures and vending machines for $5,109.43, that being the net book value thereof as of October 1, 1960; further provided for the lease by Gladieux Corporation to Southeastern of the assets so purchased on the same terms as the lease between Canteen Service and Gladieux Corporation described above at (3). This Agreement also further provided for the payment by Southeastern to Gladieux Corporation from and after October 1, 1960 of location commissions on all sales at vending locations at any time derived through Gladieux Corporation, or any corporation affiliated with Gladieux Corporation, or through Virgil A. Gladieux, at uniform rates as set forth in a schedule attached to the Agreement (32a, 34a, 175a-179a).

d. Consummation of the Agreement of June 30, 1960, as Amended.

Legal title to the assets sold, transferred and assigned to Gladieux Corporation by Canteen Service and Southeastern, respectively, according to the Agreements of January 31, 1961, was conveyed to the Gladieux Corporation by the selling corporations as and when required by the Agreements (73a, 74a, 169a-174a, 175a-179a, 209a-211a),

and payment therefor was received by Canteen Service and Southeastern (32a-34a).

On February 2, 1961 ABC delivered to Virgil A. Gladieux fifty-four thousand and two hundred (54,200) shares of its common capital stock and to Beatrice G. Gladieux fourteen thousand and three hundred (14,300) shares of its common capital stock. On February 2, 1961 Virgil A. Gladieux and Beatrice G. Gladieux transferred to ABC the outstanding shares of the thirteen (13) corporations heretofore referred to as being wholly owned by them, being those corporations referred to in the Agreement dated June 30, 1960 (150a-162a), excepting Canteen Service and Southeastern, but including Gladieux Corporation (formerly Buddies Food Services, Inc.) (35a, 36a).

During the fiscal year ended September 30, 1961, Canteen Service paid to or accrued in favor of Gladieux Corporation as rentals the sum of one hundred and twenty-one thousand one hundred and seventy-two dollars and fifteen cents ($121,172.15), pursuant to the Agreements entered into in January of 1961 by and between ABC, Virgil A. Gladieux, Canteen Service, Southeastern and Gladieux Corporation (165a-179a), and deducted that amount as rental from its gross income on its books and for federal income tax purposes (36a, 213a, Exhibit A). During the calendar years 1960 and 1961, Gladieux Corporation included in its taxable income for federal income tax purposes the amount paid to it or accrued as a liability in its favor as rental by Canteen Service during Canteen Service's year ended September 30, 1961 (36a).

During the fiscal year ended September 30, 1961, Southeastern paid to or accrued in favor of Gladieux Corporation as rentals the sum of twelve thousand two hundred and eleven dollars and thirty cents ($12,211.30),

pursuant to the Agreements entered in in January of 1961 by and between ABC, Virgil A. Gladieux, Canteen Service, Southeastern and Gladieux Corporation (165a-179a) and deducted that amount as rentals from its gross income on its books and for federal income tax purposes for that fiscal year (36a, 37a, 214a, Exhibit B), and Gladieux Corporation included in its taxable income for federal income tax purposes the amount so paid to it or accrued as a liability in its favor by Southeastern during its fiscal year ended September 30, 1961 (36a, 37a).

Pursuant to the provisions of the said agreements executed in January of 1961 (165a-179a), all location commissions payable thereunder were standardized at the rates set forth in Schedule II appended to said Agreements (42a).

(e) The Economic Realities of ABC's Relationship with the Petitioners.

The Petitioners' relationship with ABC was through the Gladieux Corporation, which was ABC's wholly owned subsidiary for equitable purposes on and after September 30, 1960 and formally so on and after February 2, 1961 (31a, 35a, 36a, 150a-162a).

Virgil A. Gladieux felt that the Petitioners would be able to operate profitably under the arrangement that he negotiated for them with ABC (66a, 67a). In the event that from and after September 30, 1960 and until October 2, 1965, Gladieux Corporation, under Section 4 of the Agreement of January 31, 1961 (175a-179a) had purchased the canteens which were rented to Southeastern by Automatic, the resulting operating income to Southeastern before dividend income and before federal income tax would have been as follows:

Fiscal Year ended September 30, 1961	$ 4,773.13
Fiscal Year ended September 29, 1962	8,239.48
Fiscal Year ended September 28, 1963	13,621.41
Fiscal Year ended October 3, 1964	12,298.26
Fiscal Year ended October 2, 1965	18,331.65

(218a.)

If the Gladieux Corporation, under Section 4 of the Agreement of January 31, 1961 (169a-174a), had purchased the canteens which were rented to Canteen Service by Automatic, the resulting operating income to Canteen Service, before dividend income and before federal income tax during the same period would have been as follows:

Fiscal Year ended September 30, 1961	$80,551.87
Fiscal Year ended September 29, 1962	36,599.54
Fiscal Year ended September 28, 1963	–0–
Fiscal Year ended October 3, 1964	–0–
Fiscal Year ended October 2, 1965	17,360.87

(217a.)

The adverse results reflected for the fiscal years ended September 28, 1963 and October 3, 1964 are attributable to the unprofitable on-street cigarette vending businesses acquired from Rex Vending Machines and Swan Sales Company in 1963 and sold in 1964 (68a, 69a).

At the time of the Tax Court hearing, Virgil A. Gladieux had in mind additional acquisitions by Canteen Service of vending businesses, but they had been deferred in order to permit Gladieux Corporation to recover from the cash requirements of the two acquisitions in 1963 (69a) which it had financed for Canteen Service. Upon acquisition of those vending businesses no rental would be payable to Automatic on the canteens involved, since the canteens would be purchased by Gladieux Corporation under the provisions of Section 4 of the Agreements of January 31, 1961 (66a, 67a, 169a-179a).

Virgil A. Gladieux also had in mind the eventual purchase by Gladieux Corporation of the canteens being

rented from Automatic by Canteen Service and Southeastern, thus eliminating the rental expense being paid to Automatic by Canteen Service and Southeastern. Any such purchase would require a substantial amount of money (67a, 69a).

In accordance with the provisions of Section 4 of the Agreements entered into on January 31, 1961, by and between Gladieux Corporation and the Petitioners (169a-179a), Gladieux Corporation expended the following amounts (or incurred liability therefor) during the periods indicated for the purchase of operating assets for lease to the Petitioners:

	Canteen Service	Southeastern
For the period Oct. 1, 1960 to Dec. 24, 1960	$ 5,569.85	$ 2,633.64
For the period Dec. 24, 1960 to Dec. 23, 1961	15,683.25	–0–
For the period Dec. 23, 1961 to Dec. 22, 1962	45,284.08	2,385.83
For the period Dec. 22, 1962 to Dec. 21, 1963	475,824.74	4,064.93
For the period Dec. 21, 1963 to Dec. 26, 1964	53,229.20	3,013.51
Totals	$595,591.12	$12,097.91

(212a)

From October 1, 1960 to December 26, 1964, the cash flow received by Gladieux Corporation for rentals from Canteen Service and Southeastern under the leases included in the Agreements of January 31, 1961 (169a-179a) amounted to four hundred and nineteen thousand and five dollars and eighty-one cents ($419,005.81). The cash outlay for assets purchased by Gladieux Corporation which were leased to Canteen Service and to Southeastern by the Gladieux Corporation under Section 4 of the Agreements (169a-179a) for this period (October 1, 1960 to December 26, 1964) amounted to five hundred and eighty thousand three hundred and four dollars and fifty-one cents ($580,304.51). The resulting net cash to Gladieux Corporation at the end of the period (December 26, 1964)

amounted to a *deficiency* of one hundred sixty-one thousand two hundred ninety-eight dollars and seventy cents ($161,298.70) (215a).

B. THE COURT OF APPEALS AND THE TAX COURT'S TREATMENT OF THE AGREEMENT OF JUNE 30, 1960, AS AMENDED BY THE AGREEMENTS OF JANUARY, 1961.

The Respondent issued his Notices of Deficiency on June 19, 1964. Pursuant to Sections 6213 and 7442 of the Internal Revenue Code of 1954 (26 U. S. C. 6213, 7442) the Petitioners filed their Petitions with the Tax Court of the United States on September 3, 1964.

1. Rentals Paid to the Gladieux Corporation.

The Court of Appeals and the Tax Court allowed Canteen Service as a rental deduction for the fiscal year ended September 30, 1961, the amount of fifty-three thousand five hundred and ninety-two dollars and seventy-nine cents ($53,592.79) (36a), which was the amount of the total depreciation, on a straight line method with various lives, charged off and deducted as an expense by Canteen Service for the fiscal year ended October 1, 1960, on the buildings, improvements, trucks, machinery, equipment, furniture and fixtures and vending machines sold by Canteen Service to Gladieux Corporation (35a) pursuant to said Agreements (165a-179a), thus disallowing as a deduction from the taxable income of Canteen Service sixty-seven thousand five hundred and seventy-nine dollars and thirty-six cents ($67,579.36) of the rentals so paid or accrued (36a, 245a).

The Court of Appeals and the Tax Court allowed Southeastern as a rental deduction for the fiscal year ended September 30, 1961, the amount of one thousand

nine hundred and six dollars and fifty-nine cents ($1,906.59) (36a, 37a), that being the amount of total depreciation, on a straight line method with various lives, charged off and deducted as an expense by Southeastern for the fiscal year ended October 1, 1960, on the trucks, furniture and fixtures and vending machines assigned by Southeastern to Gladieux Corporation (35a) pursuant to said agreements (165a-179a), thus disallowing as a deduction from the taxable income of Southeastern ten thousand three hundred and four dollars and seventy-one cents ($10,304.71) of the rentals so paid or accrued (36a, 37a, 245a).

2. Location Commissions Paid by Canteen Service.

The Court of Appeals and the Tax Court disallowed to Canteen Service, as a deduction for the fiscal year ended September 30, 1961, all location commissions paid to or accrued in favor of Gladieux Corporation with respect to sales by Canteen Service at L.O.F. and Toledo Scale Company even though these location commissions were paid or accrued for that fiscal year at the uniform rates prescribed by contract (165a-179a).

The Court of Appeals and the Tax Court disallowed to Canteen Service, as a deduction for the fiscal year ended September 30, 1961, location commissions payable to or accrued in favor of Gladieux Corporation by Canteen Service on other business (other than on L.O.F. and Toledo Scale Company business) in the amount of the excess of the commissions at the rates prescribed by contract (165a-179a) and as set forth in the schedule attached thereto over the commissions at the rates in effect prior to October 1, 1960 for the period beginning October 1, 1960 and ending February 20, 1961.

In summary, The Court of Appeals and the Tax

Court's treatment of location commissions which were paid to or accrued in favor of Gladieux Corporation by Canteen Service for the fiscal year ended September 30, 1961 under the Agreement (165a-179a) was as follows:

	Allowed as Deduction	Disallowed as Deduction
On L.O.F. business	–0–	$60,109.11
On Toledo Scale Company business	–0–	9,320.05
On other business for the three periods ending December 24, 1960	$13,541.09	3,043.45
On other business for the two periods ending February 20, 1961	7,799.03	1,615.65
On other business for the eight periods ending September 30, 1961 at the revised rates fixed by the Agreement of January 31, 1961	39,492.30	–0–
Totals	$60,832.42	$74,088.26

(38a-41a, 250a.)

The location commissions paid or accrued by Canteen Service for the fiscal year ended September 30, 1961, and which have been disallowed as a deduction from the gross income of Canteen Service for Federal Income Tax purposes, to-wit, $74,088.26, were included in the taxable income of the following corporations in the amounts and for the taxable years as follows:

Included by Gladieux Corporation in its 1960 Federal Income Tax Return	$24,286.68
Included by Gladieux Corporation in its 1961 Federal Income Tax Return	44,213.28
Included by Buddies of Lucas County, Inc. (one of the Gladieux companies acquired by ABC) in its 1961 Federal Income Tax Return	5,588.30
Total	$74,088.26

(43a, 44a.)

3. Location Commissions paid by Southeastern.

The Court of Appeals and the Tax Court for the fiscal year ended September 30, 1961, in effect have disallowed as a deduction from the gross income of Southeastern location commissions as follows:

The excess of location commissions computed at the rates fixed by the Agreement of January 31, 1961 for the three accounting periods ending on December 24, 1960 over said commissions computed for said accounting periods at the rates in effect prior to October 1, 1960	$ 995.63
The excess of location commissions computed at the rates fixed by the Agreement of January 31, 1961 for the two accounting periods ending on February 20, 1961 over said commissions computed for said accounting periods at the rates in effect prior to October 1, 1960	598.21
Local commissions disallowed	$1,593.84
	(42a, 43a, 250a.)

thereby, in effect, allowing as a deduction from the gross income of Southeastern location commissions as follows:

Location commissions subject to the Agreement of January 31, 1961 for the three accounting periods ending December 24, 1960 at the prior rates in effect	$1,138.63
Location commissions for the accounting periods ending on February 20, 1961 at the prior rates in effect	825.89
Location commissions for the eight accounting periods ending on September 30, 1961 at the rates as revised by said Agreement of January 31, 1961	5,616.21
All other location commissions for the fiscal year ended September 30, 1961 in the amounts as paid	2,046.81
Location commissions allowed	$9,627.54
	(43a.)

The location commissions paid or accrued by Southeastern for the fiscal year ended September 30, 1961, and which were disallowed as a deduction from the gross income of Southeastern for Federal Income Tax purposes, to-wit, $1,593.84, were included in the taxable income of Gladieux Corporation in its Federal Income Tax Returns as follows:

For the year 1960	$ 995.63
For the year 1961	598.21
Total	$1,593.84
	(44a.)

REASONS FOR GRANTING THE WRIT.

1. The Court of Appeals and the Tax Court both stated that the ultimate factual question before them was whether the agreements of January, 1961 between ABC, Canteen Service, Southeastern, Gladieux Corporation and Virgil A. Gladieux were the result of arms length bargaining. (Appendices A, B, pp. 7 and 40). Both Courts also held, therefore, that if those agreements of January, 1961 were the result of arms length bargaining the payments required to be made by Canteen Service and Southeastern under those agreements, and actually made to and received by Gladieux Corporation, after it had been acquired by ABC, were deductible payments under Section 162(a)(3) of the Internal Revenue Code of 1954.

In order to determine the ultimate factual question it was necessary for the Courts below to determine the ownership of the corporate parties to the bargaining. The parties to the January, 1961 agreements in question were ABC, Canteen Service, Southeastern, Gladieux Corporation and Virgil A. Gladieux. (165a-179a).

ABC was throughout the period in controversy a publicly held corporation listed on the New York Stock Exchange. (30a, 31a). At no time during or prior to January of 1961 did Virgil A. Gladieux or his wife own any stock in ABC. (30a, 31a).

Virgil A. Gladieux, throughout the period in controversy, has owned all of the outstanding stock of Petitioners, Canteen Service and Southeastern. (28a, 29a, 55a).

The Tax Court held that:

> "* * * during the entire negotiations leading up to the execution of the sale-leaseback agreements, the owner of both the lessor (Gladco) [1] and the lessees

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[1] The Tax Court referred throughout its opinion to the Gladieux Corporation as Gladco.

(petitioners) was the same person, Virgil Gladieux. Petitioners' attempt to transform such an identity of interest into a relationship which petitioners characterize as adverse, transgresses reasonable imagination." (Appendix B, p. 43.)

The Court of Appeals apparently transgressed reasonable imagination because it found that the Gladieux Corporation in January of 1961 was owned by ABC and therefore that the "identity of interest" found by the Tax Court was not present. (Appendix A, p. 4.)

Petitioners have maintained throughout this dispute that Virgil Gladieux negotiated the agreements in question on behalf of the Petitioners with ABC which was negotiating on behalf of itself and the Gladieux Corporation and therefore that those agreements were the result of arms length bargaining. Certainly the determination of which party to the bargaining owned the Gladieux Corporation during the bargaining and at the time the agreements were executed is essential to determination of whether the agreements were the result of arms length bargaining.

Although the Court of Appeals found contrary to the Tax Court's finding of fact on the essential question of who owned the Gladieux Corporation the Appellate Court came to the inconsistent conclusion that the Tax Court's findings were not clearly erroneous.

The Court of Appeals by finding the adverse relationship existed between the parties to the bargaining could not logically and reasonably find the conclusions of the Tax Court not to be clearly erroneous.

This internal inconsistency between the reviewing and trial court on the finding of the essential fact is a radical departure from the accepted and usual course of judicial proceedings.

2. All rentals and location commissions paid by Canteen Service and Southeastern under the agreements of January, 1961 have been included in the gross income of the recipient for Federal Income Tax purposes. (36a, 37a, 43a, 44a). Petitioners were required to pay and continue to be required to pay these rentals and location commissions.

It must be perfectly obvious that Petitioners cannot economically pay to ABC rentals and location commissions and at the same time pay income taxes on those amounts so paid and survive for any great length of time. For example, in the year here involved Canteen Service paid out One Hundred Twelve Thousand Seven Hundred Sixty-nine Dollars and Seventeen Cents ($112,769.17) in rentals and location commissions which were disallowed as deductions by Respondent who now is requiring a further payment of income taxes of Fifty-eight Thousand Eight Hundred Sixty-three Dollars and Seventy-three Cents ($58,863.73) on the One Hundred Twelve Thousand Seven Hundred Sixty-nine Dollars and Sixty-seven Cents ($112,769.67) which has irretrievably been expensed pursuant to contractual obligations. Canteen Service had a book net worth as of September 30, 1961 of Three Hundred Seventy-four Thousand Six Hundred Three Dollars and Seventy-five Cents ($374,603.75), and it would, therefore, appear that at the same rate per annum Canteen Service would be economically destroyed within approximately six and one-half (6½) years of this long term contract. (19a, Resp.'s Exh. A.)

> "We start with the proposition that the federal income tax is a tax on net income, * * *." *Commissioner v. Tellier,* 383 U.S. 687, 691 (1966).

In *Tellier, supra,* this Court expressed a positive antipathy to taxing gross income rather than net income.

The Internal Revenue Code and Respondent's Regulations and rulings contain a definite expression of policy against the double taxation of income where related parties are involved. § 1311 to 1314 of the Internal Revenue Code of 1954; Treas. Regs. 1.482-1(d)(2)(1962); Rev. Proc. 65-17, 1965-1 Cum. Bull. 833; and Rev. Proc. 64-54, 1964-2 Cum. Bull. 1008. Certainly no harsher result should ensue to unrelated parties.

Here the payor and recipient are unrelated. The recipient of the rentals and location commissions is not a stockholder of the Petitioners and therefore Petitioners' payments to it cannot be dividends. Since the rental and location commissions were required to be paid to the recipient and were not dividends the amounts of those payments may be subjected to the Federal Income Tax but once. One large bite from the apple by the tax collector should suffice.

3. The Courts below have relied upon *Catherine G. Armston*, 12 T.C. 539, aff'd 188 F.2d 531 (5th Cir. 1951) for the proposition that the Internal Revenue Service is not required to regard a payment as rent because it is so designated and required to be paid (Appendices A, B, pp. 6, 45). In *Armston, supra*, the lessor was the controlling stockholder of the lessee and the courts found that payments to her were dividends rather than rent because she did not, in substance, own the property asserted to have been leased from her. In *Armston, supra*, the courts had no difficulty concluding that Mr. Armston, the other stockholder of the lessee corporation and its principal executive, had devised a scheme to distribute corporate profits to his wife to be reported on her tax return. The Petitioners leased property clearly owned by the lessor. (169a, 175a, 209a-211a). No stockholder Petitioners received the payments at issue. (36a, 37a).

There is a line of authority which applies to this case. In *Skemp v. Commissioner*, 168 F.2d 598, 600 (7th Cir. 1948) reversing 8 T.C. 415 (1947) and *Brown v. Commissioner*, 180 F.2d 926, 929 (3rd Cir. 1950) reversing 12 T.C. 1095 (1949) two Courts of Appeals stated a rule of law under the antecedent provision of Section 162(a)(3) which is clearly contrary to the law adopted by the Court of Appeals in ruling on the Petitioners' appeal.

In *Skemp, supra*, and *Brown, supra*, where the lessee rented property from a trust created by him, the Court of Appeals for both the Seventh and Third Circuits said:

> "There can be no question but what rent required to be paid is properly deductible."

The Petitioners submit that the Supreme Court should resolve the conflict with the Courts of Appeals between the instant decision and *Armston, supra*, on one side, which though factually antithetic were decided on the same stated principles of law, and the decisions in *Skemp, supra*, and *Brown, supra*.

The courts below have misapplied to the Petitioners cases involving intra-family transactions or transactions involving shareholders and their controlled corporations.

The Supreme Court should settle this important question of federal law and prevent this and future misapplication of the law applicable to family and controlled corporate tax avoidance transactions to negotiated transactions between businessmen.

4. The Tax Court concluded that the agreements of January, 1961 between ABC and Gladieux Corporation on one side and Petitioners and Virgil A. Gladieux on the other were not the result of arms length bargaining. The Court of Appeals, misapplying this Court's holding in

Commissioner v. Duberstein, 363 U.S. 278 (1961), found that decision not to be clearly erroneous.

Neither court below even attempted to define the ultimate question of fact in this case; namely what is arms length bargaining. As a matter of information, Petitioners are unable to locate among the myriad of decisions and Regulations applying the criteria of arms length bargaining to taxpayers any authority defining that all important standard.[1]

The Petitioners here urge this Court to define arms length bargaining as it applies to the determination of disputes under Section 162(a)(3) of the Internal Revenue Code so that taxpayers in the future may have some standard to apply to their contractual arrangements and so that future taxpayers will not find themselves in the disastrous predicament facing the Petitioners if the courts below are not reversed.

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[1] The arms length bargaining standard has often been used, without definition, in other cases, involving Sections 162(a)(3) or its antecedent and 482 of the Internal Revenue Code. For examples see a) for Section 162 cases: *J. J. Kirk, Inc.*, 34 T.C. 130 (1960) aff'd per curiam 289 F.2d 935 (6th Cir. 1961); *Southern Ford Tractor Corporation*, 29 T.C. 833 (1958); *Stanwick's Inc. v. Commissioner*, 15 T.C. 556 (1950), aff'd 190 F.2d 84 (2nd Cir. 1951); *Potter Electric Signal and Manufacturing Co. v. Commissioner*, 29 P-H Tax Ct. Mem. 185 (1960), aff'd 286 F.2d 200 (8th Cir. 1961); b) for Section 482 cases: *Simon J. Murphy v. Commissioner*, 231 F.2d 639, 644-645 (6th Cir. 1955). No discussion of meaning of "arms length"; *Virginia Metal Products*, 33 T.C. 788, 800 (1960) (NA), reversed on other grounds 290 F.2d 675 (3rd Cir, 1961); *Friedlander Corp.*, 25 T.C. 70 (1955) (A); *Polak's Frutal Works, Inc.*, 21 T.C. 1953, 975-976 (1954) (A); *Seminole Flavor Co.*, 4 T.C. 1215, 1232-33 (1945) (A); *Koppers Co.*, 2 T.C. 152 (1943) (A); *Comm'r v. Chelsea Products*, 197 F.2d 620, 623 (3rd Cir. 1952).

CONCLUSION.

For the reasons stated above it is submitted that this Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

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